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IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,
v.
SOUTH CAROLINA DEPARTMENT OF REVENUE AND TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

BRIEF *AMICUS CURIAE* OF INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, INC. IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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BRIEF *AMICUS CURIAE* OF INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, INC. IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

INTEREST OF THE *AMICUS CURIAE* [1]

The Information Technology Association of America, Inc. ("ITAA") is the principal trade association of the nation's information technology industry. ITAA has more than 2400 direct and affiliated members, and it represents the interests of the more than 36,000 information technology companies nationwide that provide the private and public sectors with the products and services which facilitate the useful application of information technology. These products and services include application and sys-

[1] This brief is filed pursuant to Rule 37.2 of the Rules of the Court, accompanied by the written consent of all parties.

tems software for mainframe, mid-range, and personal computers; custom and contract software programming services; information systems integration services; and information processing services.

The products and services provided by the information technology industry are almost always intangible in nature. For example, computer software—instructions that direct a computer's operation—may be transferred by digital signals directly from the software producer's computer over telephone lines to the purchaser's computer so that the software never assumes a tangible form. Even when software is embodied in a physical medium, such as a floppy disk or magnetic tape, the physical medium typically has little independent economic significance. Moreover, the transfer of information technology in whatever form is usually accomplished by the owner's license of the intangible right to use such technology.

Because intangible products, services, and rights are the essence of the information technology industry, the ruling of the South Carolina Supreme Court in this case, if allowed to stand, will have an enormous and adverse impact on ITAA's membership and industry. The court ruled that a state could impose an income tax on a foreign corporation with no physical presence in the state if the corporation's licensee uses the corporation's intangible property in the state. Information technology companies have entered into millions of transactions by which they have licensed others to use intangible property in states where the technology companies themselves have no physical presence or other significant contacts. Transactions of this nature have historically not exposed ITAA's industry to income taxation in such states. However, if the South Carolina decision is allowed to stand, it would have a profound and immediate effect on ITAA's members. ITAA therefore has a strong interest in the issues presented in the Petition for a Writ of Certiorari and the outcome of the case.

SUMMARY OF ARGUMENT

The decision below expands the concept of state taxing jurisdiction well beyond the constitutional restraints on which ITAA's members and other taxpayers have reasonably relied. If left undisturbed, the decision would have a devastating impact on the information technology industry by exposing thousands of companies to taxation in states in which their intangible property is licensed but with which they have no other palpable connection. The resulting harm to the interstate market in information technology would likely be substantial as industry members were compelled to absorb unanticipated tax liabilities and to comply with unfamiliar tax laws across the country. As a result, we respectfully submit that the Court should make it clear that the "substantial nexus" requirement of the Commerce Clause bars a state from taxing a foreign corporation with no physical presence in the state merely because the corporation's intangible property is used in the state by its licensees.

ARGUMENT

BY SUBJECTING AN OUT-OF-STATE LICENSOR TO STATE INCOME TAXATION IN ANY STATE IN WHICH A LICENSEE USES THE LICENSOR'S INTANGIBLE PROPERTY, THE DECISION BELOW IGNORES THE CONSTITUTIONAL RESTRAINTS ON STATE TAX JURISDICTION AND THEREBY THREATENS TO INFLICT SERIOUS HARM ON THE INTERSTATE MARKET IN INFORMATION TECHNOLOGY

Petitioner and other *amici* have apprised the Court of the significant legal issues raised by this case, and ITAA will not burden the Court with a recapitulation of those arguments, although it subscribes to them in full. ITAA seeks instead to bring one additional point to the Court's attention: If the rule of law announced by the South Carolina Supreme Court is allowed to stand, it threatens to have a disastrous impact on the information technology

industry which has reasonably relied on its Commerce Clause immunity from state income taxation in states where it does no more than license others to use intangible property.

A. The Law on Which the Information Technology Industry Has Reasonably Relied

Prior to *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992), this Court had never seriously suggested, let alone held, that a taxpayer who was not physically present in a state could be compelled to pay a tax in that state given the restraints that the Commerce Clause imposes on state taxing authority. The "bright-line, physical-presence requirement" (*id.* at 1916) of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), fairly characterized the Court's Commerce Clause jurisprudence at that time, and in cases decided over the next 25 years the Court never cited *Bellas Hess* with anything but approval. *See, e.g., Goldberg v. Sweet*, 488 U.S. 252, 263 (1989); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 33 (1988); *National Geographic Soc'y v. State Bd. of Equalization*, 430 U.S. 551, 559-60 (1977).

To be sure, the Court in *Quill* agreed with the state court's observation that some of this Court's more recent cases had "signalled a 'retreat from the formalistic constrictions of a stringent physical presence test . . . .'" *Quill*, 112 S. Ct. at 1914 (quoting *State v. Quill Corp.*, 470 N.W.2d 203, 214 (N.D. 1991)). But the Court nevertheless recognized that all of the cases the state court had invoked for this proposition "involved taxpayers who had a physical presence in the taxing state and therefore do not directly conflict with the rule of *Bellas Hess* . . . ." *Id.* at 1914. Indeed, the Court in *Quill* explicitly acknowledged that the licensing of software by an out-of-state licensor of information technology to an in-state licensee does not "comprise the 'substantial nexus'

required by the Commerce Clause." *Id.* at 1907 n.1. The Court further declared in *Quill* that:

> The State "concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus." . . . We agree. Although title to "a few floppy diskettes" present in a State might constitute some minimal nexus, in *National Geographic Society v. California Bd. of Equalizaton*, 430 U.S. 551, 556 (1977), we expressly rejected a " 'slightest presence' standard of constitutional nexus." We therefore conclude that Quill's licensing of software in this case does not meet the "substantial nexus" requirement of the Commerce Clause.

Id. at 1914 n.8.

In light of the clear rule of law prior to the Court's decision in *Quill* that physical presence was a necessary condition to the assertion of state tax jurisdiction, it would have taken considerable omniscience for a taxpayer to foresee that the Court, in 1992, would reaffirm the bright-line, physical-presence standard of "substantial nexus" under the Commerce Clause for sales and use taxes while leaving open the question whether this Commerce Clause standard applied with equal force to other types of taxes, including income taxes. Accordingly, members of the information technology industry were entirely justified, at least prior to this Court's decision in *Quill*, in relying on the settled rule that physical presence in a state was an essential prerequisite to the power of a state to tax a foreign corporation.

B. The Effects on the Information Technology Industry of Allowing the Decision Below To Stand

If the decision below is allowed to stand, and with it the rule that the licensor of intangible property is subject to tax wherever its licensee uses the property, the impact on the information technology industry would be swift and harsh. It is no secret that tax administrators across

the country are poised to use the decision below to their full advantage should the Court deny review. *See* Pet. at 20-22.[2] Consequently, should the Court decline to review the decision below, ITAA's members can expect an immediate response from state tax administrators.

Moreover, no industry is more vulnerable to the adverse consequences of the taxing authorities' widespread embrace of the South Carolina decision than the information technology industry. The dominant mode of conducting business in the information technology industry is through the licensing of intangible assets in order to protect the developers' intangible intellectual property rights. "The vast majority of software vendors," for example, offer their products through a "perpetual license." Culpepper & Associates, *Software Pricing Trends* 181 (1990). Thus, a typical software license provides that "Licensor grants to Licensee, and Licensee accepts from Licensor, a perpetual non-exclusive and non-transferable license to use the current version of Licensor's software." Richard Raysman and Peter Brown, *Computer Law: Drafting and Negotiating Forms and Agreements* § 7.15 (1991).

Under the reasoning of the decision below, software producers across the country will suddenly find themselves subject to the taxing jurisdiction of every state in which their licensees use the software, even though the technology producers have no other contact with the taxing state. Not only will such liability be wholly unanticipated (*see supra* pp. 4-5), it will also be wholly unpredictable. A software producer that licensed its product to a licensee in State A will unexpectedly find itself subject to income tax jurisdiction in State B when its licensee moves from State A to State B. Furthermore, software licensed to a customer in State A may be copied and distributed, under the terms of the license, both within the customer's own organization and to third parties all over the world,

[2] All citations to the Petition for a Writ of Certiorari are designated "Pet." followed by a page reference.

thereby exposing the licensor to taxation in a multitude of jurisdictions.

The burden on software producers to comply with the tax laws of all the states in which their licensees are located at the time the license agreement is consummated would be onerous enough. If, in addition, the producers are required to monitor their licensees' *future* activities to determine the states from which the producers might at some future time be deemed to be deriving the "benefit of economic contact" (Pet. App. A at 5a), it would be overwhelming. If the "substantial nexus" requirement of the Commerce Clause means anything, it must be that it prohibits the erosion of the free trade purposes underlying the Clause that would be caused by an acceptance of the sweeping conception of state taxing jurisdiction embodied in the decision below.

Software producers are not the only members of the information technology industry that would be devastated by the repercussions of the South Carolina court's decision. Local and network-based data processors, database providers, and systems integrators would suffer similar problems. If the use by another of a producer's intangible property is a proper predicate for state tax jurisdiction over the producer, these information technology providers will confront staggering burdens. They would be required to comply with the state tax laws of every state in which their customers, often with multiple locations, used the information technology, because, at least in the eyes of the court below, they would have "been aware of, consented to, and benefitted from" (Pet. App. A at 5a) their customers' use of their intangibles in the taxing state.

Perhaps the most pernicious aspect of the decision below from the standpoint of the information technology industry is the tremendous uncertainty it has already spawned regarding the industry's past and future state tax payment and reporting obligations. Since industry members have been operating under the reasonable as-

sumption that the mere licensing of intangible property to others did not subject them to income tax jurisdiction in the states where their licensees used the property, *see supra* pp. 4-5, they have not filed income tax returns in states where their only connection is the "presence" of their intangible property in the hands of their licensees. Because taxpayers who failed to file returns are not protected by statutes of limitations, the information technology industry faces potentially crushing past tax liabilities if the decision below stands and is applied retroactively, as this Court's decisions suggest it well could be. *See Harper v. Virginia Dept. of Taxation*, 113 S. Ct. 2510 (1993).

Uncertainty regarding the future application of the decision below, if not reversed by this Court, is as troublesome as the specter of its retroactive application. Once unleashed, the principle enunciated by the South Carolina court knows no bounds. For an industry whose principal product is intangible property, and whose basic transaction is the license of such property, the prospect that the use by another of one's intangible property provides a constitutional predicate for the exercise of state taxing authority is a cause for immense concern. Virtually every agreement entered into by even the smallest producer of information technology will expose the producer to taxation in every state where his customer uses—or in the future chooses to use—the license. Under the principle upon which the decision below is based, this is so regardless of any other contacts that the taxpayer may have with the taxing state because it is the intangible assets themselves, not the owner's concrete activities in producing or protecting those assets, that provide the foundation for state tax jurisdiction. Furthermore, in light of the fact that intangible property is not susceptible to precise geographical identification, and many different states can often lay a legitimate tax claim to the same intangible, *Curry v. McCanless*, 307 U.S. 357, 372-74 (1939), or the income it generates, *Guaranty Trust Co. v. Virginia*, 305 U.S. 19, 22-23 (1938), there is no natural limit to the cumulative

tax burdens that would confront the information technology industry if the decision below is left undisturbed.

CONCLUSION

Because the decision below will create severe, unwarranted, and unanticipated burdens on the information technology industry, ITAA urges the Court to grant the Petition for a Writ of Certiorari and thereafter reverse the decision of the Supreme Court of South Carolina.

Respectfully submitted,

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